INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, IT & MANAGEMENT

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REVIVING UP INDIAN VC INDUSTRY: LESSONS FROM USA

NEHARIKA SOBTI
DOCTORAL CANDIDATE
DEPARTMENT OF FINANCIAL STUDIES
UNIVERSITY OF DELHI
DELHI

ABSTRACT

The paper aims to collate the existing literature on the evolution of venture capital industry in USA in order to aggrandize the level of understanding regarding its operations, performance and factors determining its success. Being a pioneering financial institution in USA, VC industry with its unprecedented growth is testimony to the fact that they help entrepreneurs to strengthen the company by providing not just capital but also expertise, networks and economies of scale in fundraising. A well-functioning VC industry is a prerequisite for the growth and development of high tech novel ideas and processes which ultimately leads to increase in GDP of the economy. The paper tries to examine microstructure of VC industry, cycle, factors affecting its success, deal terms, historical background, current scenario and predictions regarding the future of venture capital industry. Using industry data from 1995-2015, an attempt has been made to analyse the VC industry in USA to draw meaningful insights regarding deals, fundraising, investments, exit, composition of investment on the basis of type of investors and geographic area and aims to recommend plausible solutions for the growth of a robust entrepreneurial ecosystem in emerging economies like India.

KEYWORDS

USA, venture capital, fundraising, investment, exit, performance.

INTRODUCTION

The increased euphoria of the government of emerging economies to spur growth and job creation have made for a strong stance for the establishment of a robust venture capital industry either through direct participation in the form of government venture capital programs or through indirect efforts aimed at creating the right institutional environment. Entrepreneurial firms characterized by significant intangible assets, expecting years of negative return, having limited operating history and have uncertain prospects are unlikely to receive bank loans or debt financing. This calls for a strong and vibrant venture capital industry to boost the entrepreneurial spirit by building a fertile ground for innovation by providing adequate capital infusion, managerial and technical expertise.

(Gompers & Lerner, 2001) defined venture capital as an independent, professionally managed, dedicated pools of capital that focus on equity or equity linked investments in privately held, high growth companies. VC are, thus, alternative investment vehicles which pools large sums of money from institutional investors like pension funds to invest in highly risky and unproven ventures. The argument in favor of the need to adopt the VC framework stands on the basic macroeconomic theory that to produce output which is brought through innovation of young entrepreneurs, there needs to be an optimum combination of labour and capital which is brought by VCs.

The role of VC is to fill the funding gap by providing seed and early stage financing to emerging companies in return for equity stake and seat on board and earn returns by way of IPO or acquisition. So, in its functioning, VC represent a variant of private equity. The main goal of VC industry is to create fast-growing and sustainable companies, introduce new technologies, and increase growth potential of the economies, while providing an attractive return to those who trust the industry with their capital. Since the VC industry of the emerging economies needs to learn a lot from the its pioneers, it behooves us to take a look at mature and highly successful VC industry of USA and draw meaningful insights from the same.

This paper tries to present a brief history of the evolution of VC industry in USA by analysing its historical background, current state of performance and predicting the future growth prospects of it. VC has been undoubtedly a successful institution solving the most difficult problem of financing new ventures and providing a strong impetus for development of entrepreneurship in the USA. Being a very importance source of entrepreneurial finance, majority of successful IPOs in USA are VC backed and this model is widely copied around the world

OBJECTIVES

The main aim of this paper is to explore various aspects of venture capital industry in US and draw insights for developing a robust VC industry in India by answering following research questions-

- To examine the scope of venture capital industry in USA
- To explore the evolution of venture capital industry and trace its performance.
- To examine the problems that VC industry solves for US economy as a whole.
- To understand the microstructure of VC industry in US
- Will it disrupt the existing sources of entrepreneurial finance?
- What are the determinants of a successful VC industry?
- What is the role of government in promoting VC industry?
- How successful has VC industry in US in terms of performance trends from the period 1995- 2015?

RESEARCH DESIGN

An exploratory research is carried out by undertaking conventional method of research by reviewing the literature, surveys from different consultancy firms, expert opinions, past interviews, industry reports from VC associations, and blogs. Secondary data pertaining to performance statistics were taken from databases maintained by VC associations and independent industry reports for the period of 1995-2015. By analysing the trends and past outcomes, insights were drawn with regard to its success and adaptation of this model across the globe.

REVIEW OF LITERATURE

Venture capital is a relatively small financial institution in US. In the five years from 2009 to 2013, the National Venture Capital Association (2014) reports that an average of fewer than 1,200 firms received venture capital for the first time annually in the U.S. Over the same five-year period, U.S. venture capital partnerships received an average of less than $18 billion in new capital commitments from investors each year. And these figures are for the U.S., by far the largest market for venture capital in the world.

So why then does venture capital receive a large amount of theoretical, empirical, policy and media interest? From a theoretical perspective, venture capital is particularly interesting because it encompasses the extremes of many corporate finance challenges: uncertainty, information asymmetry and asset intangibility. At the same time, from an empirical and policy perspective, venture capital has had a disproportionate impact. (Kortum & Lerner, 2000) find that venture capital is three to four times more powerful than corporate R&D as a spur to innovation. Kaplan and (S. N. Kaplan & Lerner, 2009) find that roughly 50% of the "entrepreneurial" IPOs in recent years are venture-backed despite the fact that only 0.2% of all firms receive venture funding.

Uncertainty and informational asymmetries often characterize young firms, particularly in high-technology industries. If all the outcomes of the entrepreneurial firm cannot be foreseen, and effort of the entrepreneur cannot be ascertained with complete confidence, it may be difficult to write a contract governing the financing of the firm. That's why, these specialized financial intermediaries called Venture Capital alleviate these information gaps by scrutinizing the firm intensively and monitoring it by meting out financing in discrete stages over time; syndicating investments with other venture capital firms; taking seats on a firm's board of directors; and compensation arrangements including stock options.

(NVCA, 2015) reports that much of venture capital's success has come from the entrepreneurial spirit pervasive in the American culture, financial recognition of success, access to good science, and fair and open capital markets. protection of intellectual property, and a skilled workforce.

(Black & Gilson, 1998) argue that the key source of the U.S. competitive advantage in venture capital is the existence of a robust market for initial public offerings enabling VCs to transfer control back to the entrepreneur when a public equity market for new issues exists. Thus, by removing the hindrance of moral hazard (agency problem) and information asymmetry through intensive screening procedure (Chan, 1983), financial contracts (S. Kaplan, 2003), stage funding (Admati, 1994) and seat on board to closely monitor the performance and advise the management (Rin & Hellmann, 2012), VC ensures ethical governance and investor protection.

(Gorman & Sahlman, 1989) argued that the nascent deployment of venture capital in other countries is gated by a country's or region's cultural fit, tolerance for failure, services infrastructure that supports developing companies, intellectual property protection, efficient capital markets, and the willingness of big business to purchase from small companies.

(Gompers, 1998) show that venture capital backing adds value even after the initial public offering: venture-backed companies substantially outperform non venture-backed firms in the public aftermarket. (Barry & Barry, 2010) found that returns from venture capital investments can only be observed many years after the original investments because private firms are valued at cost until they are sold or taken public many years later.

(Fellow, Marion, & Foundation, 2009), (Wright, Pruthi, & Lockett, 2005),.(Lerner & Tåg, 2013) found that the firm performance has a dramatic effect on fundraising. Both the value of equity held in firms taken public by the venture capital firm in the current year and in the previous year have a positive effect on the probability of raising a new fund and the size of the fund. The effect of the previous year's IPO volume is nearly four times as large as the current year's. This might be due to the long process of raising a new fund (which may take many months

(Klonowski, 2006), (Michelacci & Suarez, 2004), (Kortum & Lerner, 2000),(Hall, 2002), (Djankov, 2010) and (Lerner & Tåg, 2013) have found that the institutional environment, in particular, the legal environment, financial market development, the tax system, labor market regulations, and public spending on research and development indeed correlates with success of local venture capital activities. (Gompers & Lerner, 2010) found commitment by tax exempt and taxable investors are equally sensitive to changes in capital gain tax, consistent with the notion that decrease in capital gain tax rates increase the demand for VC as more people try to become entrepreneurs.

(S. N. Kaplan, Sensoy, & Strömberg, 2002) provides an extensive empirical research on the persistence of VC but found that fund size is the enemy of persistence. General partners(GP) who have funds with good returns tend to get bigger. Persistence research has an important implication that persistence is found irrespective of the size of the fund but it not a guarantee.

(Gompers & Lerner, 2010) found that reputation also appears to have a positive effect on the size of the fund raised as it captures beliefs about future returns not captured in recent performance variables. Older and larger venture organizations have higher probabilities of raising funds and raise larger funds.

OVERVIEW OF VENTURE CAPITAL INDUSTRY IN USA

EVOLUTION OF VC INDUSTRY IN USA

The origin of modern private equity started with the first true venture capital firm American Research and Development (ARD), established in 1946 by MIT President Karl Compton, General Georges F. Doriot, who was a professor at Harvard Business School, and local business leaders. This small group made high-risk investments in emerging companies that were based on technology developed by soldiers returning from World War II. The success of the investments began when almost half of ARD's profits during its 26-year existence as an independent entity came from its $70,000 investment in Digital Equipment Company in 1957, which grew in value to $355 million. ARD was structured as a publicly traded closed-end fund. Initially, institutional investors showed little interest in VC funds due to unproven style of investing and hence ADR was mostly targeted to individuals (S. N. Kaplan & Lerner, 2009).

Then, limited partnership was introduced in VC industry with the was the passage of the Small Business Investment Act of 1958 which pushed for ventures with predefined lifeline which provided liquidity to investors as assets were returned back after the set period. The federal government played an important role in pushing VC industry by forming SBIC (Small business investment company) exploiting breakthroughs in electronic, medical, or data-processing technology, as a result of which, venture capital came to be almost synonymous with technology finance.

1970s marked the coming up of independent investment firms and setting up of National Venture Capital Association (NVCA) to serve as the industry trade group for the venture capital industry. The disbursement of VC funds was biased towards information technology industries, especially communications and networking, software, and information services that led to the most successful high-technology companies during the 1980s and 1990s, including Apple Computer, Cisco Systems, Genentech, Microsoft, Netscape, and Sun Microsystems. Facing huge shock from Nasdaq and technology slump in 2000, VC still tried to maintain steady level of deals till 2007.

FUNCTIONS AND ROLES

Venture capital has enabled the United States to support its entrepreneurial talent and appetite by turning latent ideas and basic science into products and services to freestanding and mature organizations. Being an important financial intermediary, it performs three basic functions in order to mitigate agency conflicts which arise between entrepreneurial firms and outside investors. First, VCs spend a large amount of resources and time systematically screening deals, consider the attractiveness and risks of the opportunity by looking at market size, strategy, technology, customer adoption, and competition; the management team; and the deal terms and finally, selecting deals. Second, VCs engage in sophisticated contracting and structuring of their investments such that the VC does not get involved / exert control if the entrepreneur performs; but the VC takes control if the entrepreneur does not perform by carefully allocating cash flow rights, control rights and employment terms. Third, VC performs various value added services of monitoring, governance, recruitment, strategy formulation and networking.

KEY PLAYERS AND STAGES OF VC FINANCING

Typically, a venture capital firm will create a Limited Partnership with the investors as LPs and the firm itself as the General Partner (GP). Each "fund," or portfolio, is a separate partnership and is established when the venture capital firm obtains necessary commitments from its investors. Since the investment is illiquid and have long gestation period ranging from 8-10 years, VC are expected to carry out due diligence process in order to increase the likelihood of reaching the exit stage to garner returns. VC play an important role in 4 stages of venture development - idea generation, start up, ramp up and exit. These unknown privately held ventures see the light of the day by meeting the VC is via a strong web of networks through referrals from the investors' trusted sources and other business contacts; investor conferences and symposia, and summits where companies pitch directly to investor groups in face-to-face meetings like speed venturing. Typically, there are 5 stages of VC financing corresponding to different levels of venture growth curve.

1. **Seed stage -** This is setup stage wherein venture comes up with an idea or product prototype and has to convince the VC regarding the economic and technical feasibility of the product. The downside risk is tremendously high.
2. **Start-up stage -** This stage involves proof of testing and market research in order to launch the product for the first time in the market.
3. **Second stage -** This involves funding for commercial manufacturing and working capital requirement.
4. **Third stage -** This involves expansion to meet the rapidly growing demand and develop follow up products.
5. **Bridge/Pre-public stage -** This involves mezzanine financing for exiting via IPO or acquisitions.

KEY DETERMINANTS OF SUCCESS OF VC INDUSTRY IN US

An important factor for the increase in venture capital in US is probably a huge increase in the number of high quality startups leading to more demand for venture financing. Policies that increase the relative attractiveness of becoming an entrepreneur and promote technology innovation probably would have more of an effect on venture capital investments than an across the board cut in the capital gains tax rate.

But VC industry can't grow on its own initially, it needs strong positive externalities in the form of active government policy, structures, experiences, peers, inter-mediaries, investors and continuous research and innovation. The legal environment in a country affects the extent to which efficient contracts between venture capitalists and entrepreneurs can be written and enforced and has implications for how entrepreneurs are compensated, screened and monitored. The presence of well-developed stock markets will then boost the liquidity of an active venture capital market because holding periods are shortened, and more young and innovative firms are able to benefit from the skills and capital venture capitalists provide. An extensive literature has shown a negative relation between taxation and entry into entrepreneurship through diminishing the gains from starting a new business, as expected profits when the firm matures are lower.

Apart from them, there are a number of other institutional support that are essential but can't be quantified like the attitudes toward entrepreneurship shaped by culture and religion, educational institutions, mass media and peers. The better the environment, the more viable is a career as an entrepreneur, the more people enter entrepreneurship, which helps create a critical mass of entrepreneurs needed for a local venture capital market to develop.

DESCRIPTIVE ANALYSIS

PERFORMANCE AND TRENDS

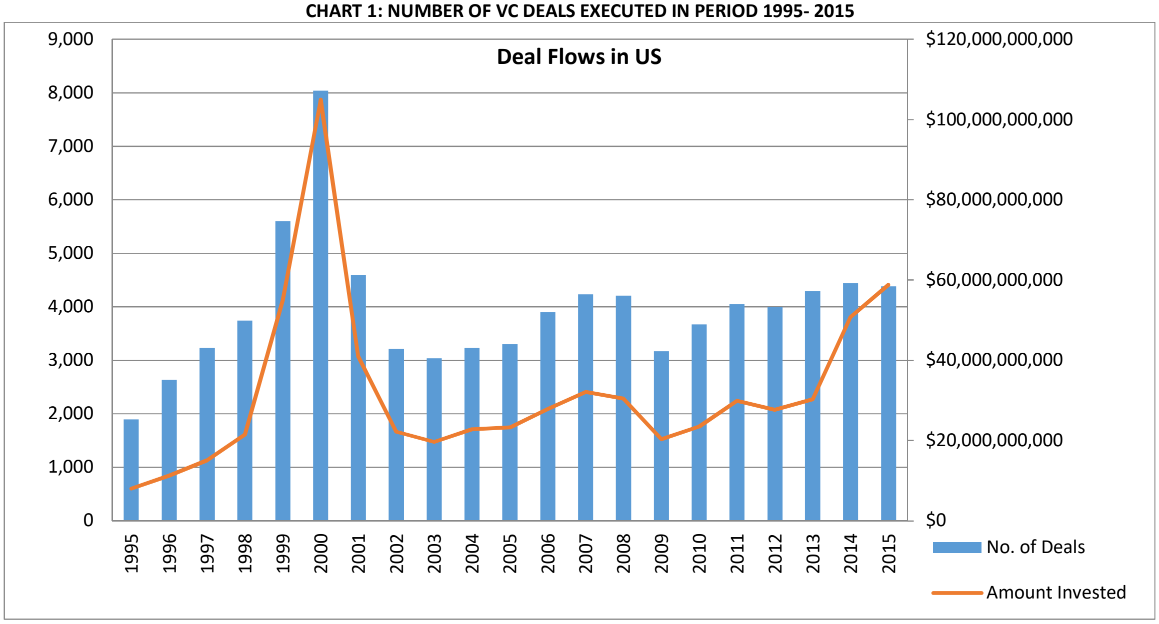
2015 was a record-setting year for venture capital, with over $128 billion of total investment made worldwide, topping 2014's total by 44 percent. What sets 2015 apart, however, lies in the size and scope of the venture capital (VC) investments that were made. Investors saw this potential and made significant investments by allowing 71 VC-backed companies achieved Unicorn status ($1 billion valuation) during the year, compared to 53 in 2014[1]. An uncertain global economy, a projected slowdown in China, and expected interest rate increases following the recent increase in the US seem to be driving some investors to hold back their investment dollars. These trends, along with a number of Q4'15 IPOs falling short of recent private valuations appear to be making investors more cautious.

This paper tries to analyse the available secondary data on the venture capital activity in the US from the period 1995-2015 focusing on three statistics: fundraising, investing and exiting. These statistics may be indicative of the strength of venture capital development in these countries. The fundraising activity indicates the attractiveness of the market to potential investors, both domestic and foreign. The investment activity reflects the amount of high quality projects found by venture capitalists. Lastly, exit or realization activity denotes the venture capitalists' ability to convert their illiquid investments into cash, be it at a profit or a loss.

DEAL FLOWS

The performance of VC industry in USA has seen highs and lows. The main determinant of the robust VC industry is the no. of deals undertaken by VC. **Chart 1** deals with the number of VC deals from 1995 which grew enormously until the dot com bubble in the year 2000 and then due of stock market crash, the number fell drastically and then stabilized over the course until 2015.

CHART 1: NUMBER OF VC DEALS EXECUTED IN PERIOD 1995- 2015



Data Source- PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report, Data: Thomson Reuters

For every 100 business plans that come to a venture capital firm for funding, usually only 10 or so get a serious look, and only one ends up being funded. The venture capital firm looks at the management team, the concept, the marketplace, fit to the fund's objectives, the value-added potential for the firm, and the capital needed to build a successful business.

Table 1 shows a comparative analysis of the no. of deals and the amount invested by VC in last two decades. The no. of deals rose by 4 times from 1995 to 2015 and the amount invested rose by 7 times for the same period. The quarterly data shows uneven variation within a year. This points to the strong deal flows observed in the that period.

TABLE 1: AMOUNTS INVESTED BY VC IN 20 YEARS

Quarter	1995		2005		2015	
	No. of Deals	Amount Invested	No. of Deals	Amount Invested	No. of Deals	Amount Invested
1	503	$1,690,040,500	763	$5,222,331,500	1,063	$13,555,679,100
2	466	$2,546,374,500	862	$6,149,008,500	1,206	$17,310,376,700
3	434	$1,709,754,500	813	$6,068,106,000	1,149	$16,605,830,600
4	494	$2,070,353,900	864	$5,805,921,700	962	$11,339,301,900
Grand Total	1,897	$8,016,523,400	3,302	$23,245,367,700	4,380	$58,811,188,300

Source: PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report, Data: Thomson Reuters

[1] Venture Pulse, Q4'15, Global Analysis of Venture Funding, KPMG International and CB Insights (data provided by CB Insights) January 19th, 2016

FUNDRAISING

Commitments are defined as the pledges that venture capitalists receive for investment over the lifetime of the fund. They are not the amount of money that is actually invested in a given year. Typically, venture funds draw on and invest the committed capital over a two to three year time period. Commitments to the venture capital industry have been highly variable over the past 30 years. The historical patterns of commitments to U.S. VC funds and investments in companies by those funds represent a remarkably constant 0.15% of the total value of the stock market.

TABLE 2: CURRENT AND HISTORICAL SNAPSHOT OF VC COMMITMENT

Indicator	2015	2005
Number of Active VC Firms	-	505
Number of Funds	1,331	1,785
Average Fund Size ($M)	144.9	147.8
Total Capital Managed ($M)	192,900	263,800
Total Cumulative Funds	4,957	3,282
New Capital Raised ($M)	29,826	19,154

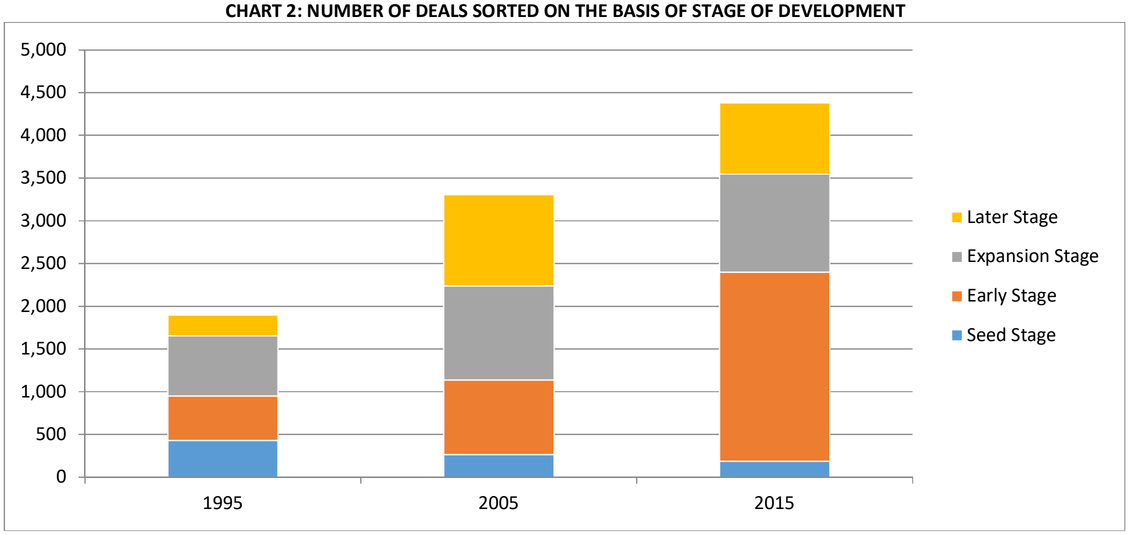
Source: QUANDL, 2015

Commitments to VC funds, while more variable, are consistently in the 0.10% to 0.20% range. The level of commitments to and the investment pace of VC funds has been consistent with the historic averages since 2002. At the same time, returns relative to the overall stock market appear to have been roughly average. This does not suggest to us that there is too much money in U.S. VC, nor does it indicate to us that the VC model is broken. It seems to be the natural evolution of a relatively competitive market.

VENTURE INVESTING

Staged capital infusion may be the most potent control mechanism a venture capitalist can employ. Staged capital infusion keeps the owner/ manager on a "tight leash" and reduces potential losses from bad decisions. The venture capitalist can increase the duration of funding and reduce the frequency of reevaluation as the company becomes better established and conflicts with the entrepreneur appear more likely.

CHART 2: NUMBER OF DEALS SORTED ON THE BASIS OF STAGE OF DEVELOPMENT

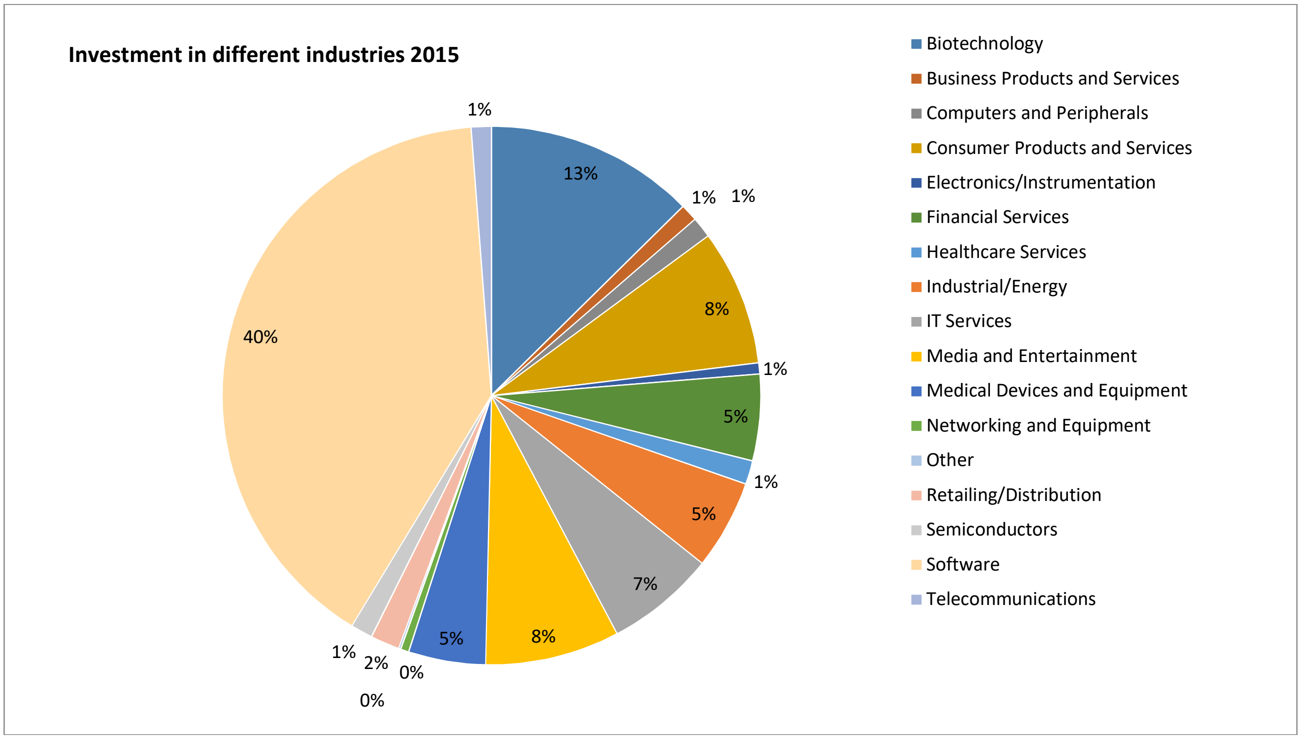


Data Source- PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report, Data: Thomson Reuters

Chart 2 shows that there has been a decrease in seed stage financing by VC from 1995 to 2015 due to emergence of angel investors, incubators and crowd funding platforms. There has been a huge increase in early stage funding by VC showing that VC has started focusing more on novel ideas and business plan helping them in their testing of proof of concept and marketing initial product. The expansion stage showed a very stable growth. But, later stage financing showed a slight fall from the previous decade due to IPO drought faced by US after subprime crisis and hence, more focus on acquisition as an exit strategy.

The nature of sector wise focus and completed investment transactions reflect the types of available projects, demand for specific products and services, sophistication of financial investors, and the development of the financial institutions seen in the market. The initial investments focused on basic sectors such as manufacturing, construction, food processing, and services and investments. In later years, the focus was on communications, manufacturing, and services. **Chart 3** shows that the majority of the investment by VC in 2015 went towards software industry signifying the mushrooming of internet based startups and services. Biotechnology was another favorite industry for VC in the year 2015. IT services, FMCG, financial service, medicine, media and energy showed stable contribution by VC.

CHART 3: VC INVESTMENT IN DIFFERENT INDUSTRIES IN 2015



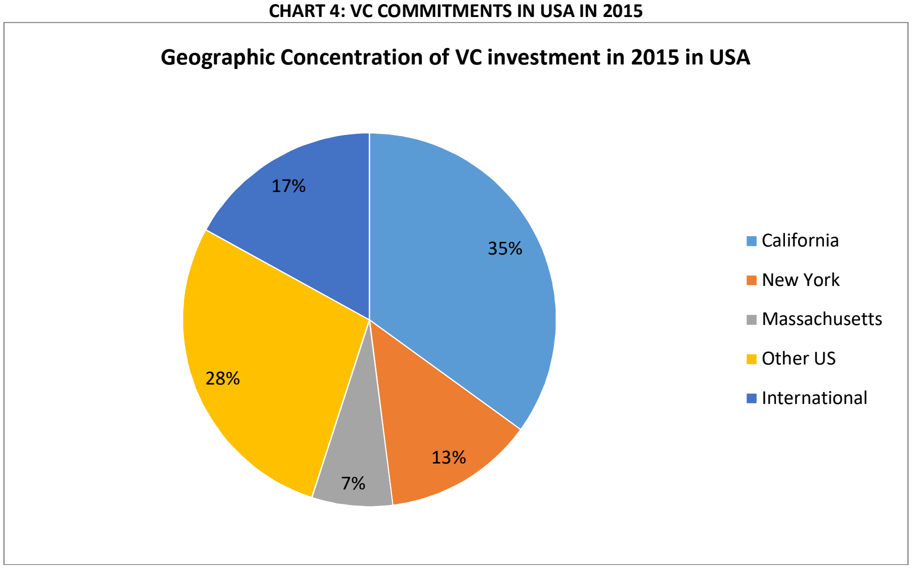
Data Source - PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report, Data: Thomson Reuters

GEOGRAPHIC CONCENTRATION

Chart 4 shows that the VC commitment in 2015 has been quite uneven geographically with majority of deals concentrated in California while minor trends seen in other parts of the country.

This points towards the phenomenon of unequal rise of entrepreneurship in different states across USA.

CHART 4: VC COMMITMENTS IN USA IN 2015

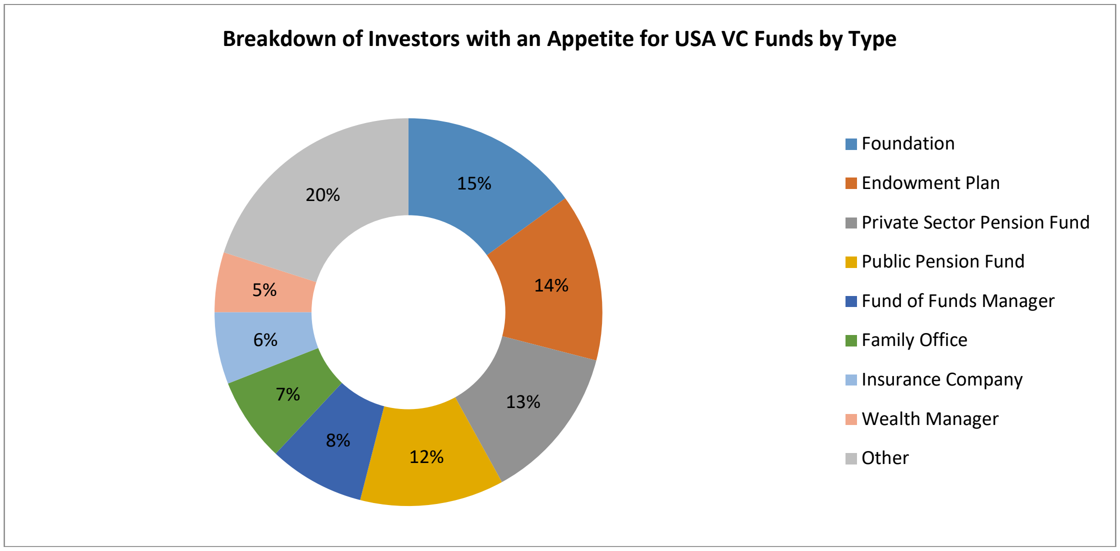


Data Source - Preqin Investor Intelligence, 2015

Geographic location of the largest venture firms is increasingly concentrated. California-domiciled firms managed 35% of the capital, compared with 49% a year earlier. This is due to large California firms raising the larger funds, and the relocation of some east coast firms to the west. Contrary to some popular misconceptions, only 31 firms managed more than $1 billion. By comparison, 360 firms managed $25 million or less The longer-term drivers of venture capital financing.

Chart 5 shows that majority of the investment in VC funds are done by Pension funds in US followed by foundations and endowment plans. This proves the risk taking ability inherent in American culture of free enterprises as they are ready to invest their pension money in highly risky investment alternative like VC funds.

CHART 5: TYPE OF INVESTORS INVESTING IN VC FUNDS IN 2015



Data Source - Preqin Investor Intelligence, 2015

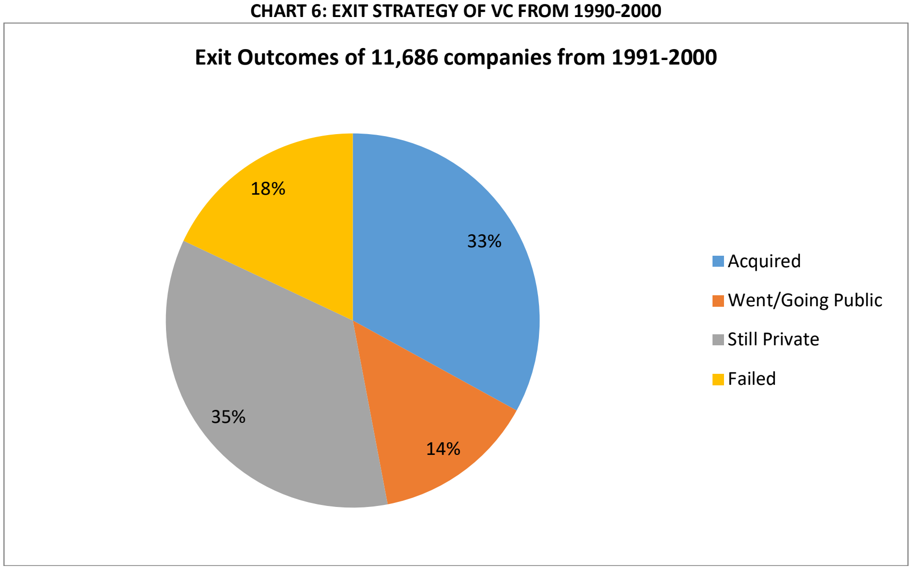
EXIT STRATEGY

Once successful portfolio companies mature, venture funds generally exit their positions in those companies by taking them public through an initial public offering (IPO) or by selling them to presumably larger organizations (acquisition, trade sale, or increasingly a financial buyer). This then lets the venture fund distribute the proceeds to investors, raise a new fund for future investment, and invest in the next generation of companies. In order to measure the performance of VC, it is not possible to calculate risk and return of VC funds rather we use a measure of the market value of equity held by venture capitalists in firms that went public in a particular year.

VC exit strategy was not dominated by IPO initially in the year 1985 by started taking a jump in the year 1994 onwards and reached its peak at 300 IPO in just before the dotcom bubble burst in; ate 1990's and then due to crash in stock market, the IPO drought was observed for several years until US financial crisis and then started showing some revival in late 2013. The offer amount of IPO moved in relation to the no. of deals except in 2011 onwards where the IPO offer reached $23 billion but the no. of deals was comparatively less.

Chart 6 shows that in the decade from 1990-2000, majority of the startups were still held privately and VC funds were invested in them. Large portion of them got acquired and on 14% went for IPO and 18% failed. This data reveals that VC industry was not a success as it was not able to garner returns and its funds were blocked for a very long gestation period.

CHART 6: EXIT STRATEGY OF VC FROM 1990-2000



Source - NVCA Yearbook 2015

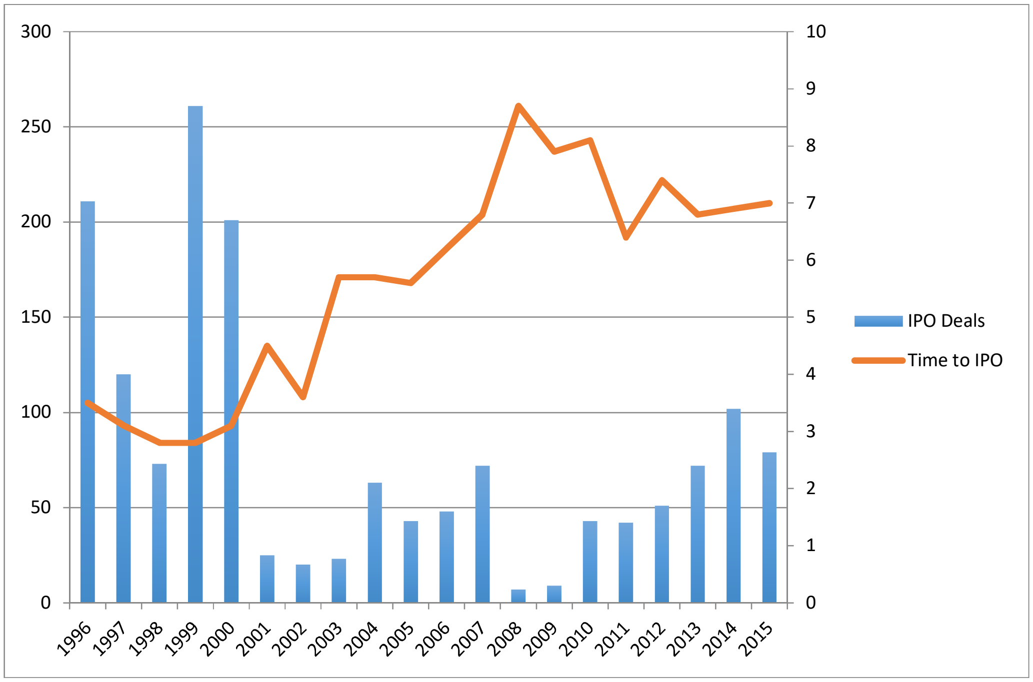
Chart 7 shows that 79 venture-backed initial public offerings (IPOs) raised $9.4 billion in 2015, marking a 40 percent decline in dollars raised compared to 2014[2].

Chart 8 shows that 578 venture-backed M&A deals were reported in the 2015, 26 of which had an aggregate deal value of $3.6 billion, decreasing 48 percent compared to the third quarter of this year. For full year 2015, 372 M&A transactions were reported, with 84 deals combining for a disclosed value of $16.3 billion, the slowest full year period for venture-backed M&A since 2009[3].

[2] Exit Poll Report, 2015 by Thomson Reuters and the National Venture Capital Association (NVCA).

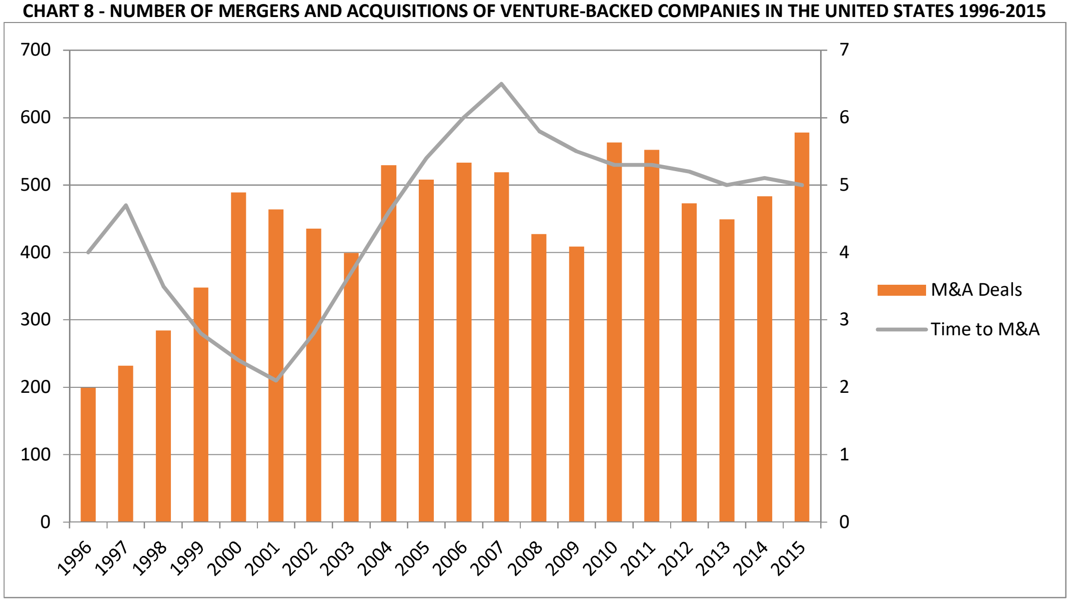
[3] Exit Poll Report, 2015 by Thomson Reuters and the National Venture Capital Association (NVCA).

CHART 7: NUMBER OF VENTURE-BACKED IPO COMPANIES IN THE UNITED STATES FROM 1996-2015



Data Source - Dow Jones Venture

CHART 8 - NUMBER OF MERGERS AND ACQUISITIONS OF VENTURE-BACKED COMPANIES IN THE UNITED STATES 1996-2015



Data Source - Dow Jones Venture

OBSERVATIONS

- In 2014, the venture capital market produced its strongest performance in terms of both financing and liquidity activity since the end of the dot-com boom. Deal flow approached its highest level since 2000, total venture capital financing proceeds soared to the second highest level in history, the median pre money valuation hit a record level, the number of VC-backed US issuer IPOs was the largest since 2000, and the median acquisition price for VC-backed companies was the highest since 2000. Year 2015 proved to be a lousy year for VC industry as both the VC backed IPO and VC investment saw a dip.
- VC industry is witnessing traction in 2015 due to the mushrooming of incubators angel investors and crowd funding platforms meeting the seed and early finance requirement and due to this VC investment are dominating the later stage financing in US and emerging markets.
- The effectiveness of public efforts to transfer the venture capital model to other regions is highly debatable. Even if venture capital organizations spur technological innovation in the United States, it is not evident that the model can be seamlessly transferred abroad. Different employment practices, regulatory policies, or public market avenues might limit the formation these funds.
- Overseas venture initiatives may be able to benefit from the experience of venture organizations in the United States. In particular, the Israeli Yozma program seems to have successfully captured “spillovers” of knowledge from U.S. and British venture organizations.
- Venture capitalists focus on scale or potential for scale, rather than profitability. VC-financed firms are significantly larger when they fail in terms of employees and sales, but they are not very different in terms of profitability at the time of failure.
- Whether VC-financed firms fail more often is a function of the time period under consideration. The probability of a VC-financed firm failing is much lower than a non-VC-financed firm, but the probability of a VC-financed firm failing is higher than for non-VC-financed firm’s conditional on their having survived for more than five years. Thus, venture capitalists allow firms time to grow and appear to be “patient” but only to a certain point.

POLICY IMPLICATION FOR INDIAN VC INDUSTRY

This research has a variety of implications for policy makers who wish to stimulate venture capital activity in the emerging economies like India

- **For Entrepreneurs -** Robust entrepreneurial ventures is a precondition for a thriving VC industry so budding entrepreneurs in India should keep innovating and develop new products/services and ensure a constant flow of opportunities that have enormous upside potential.
- **For Financial institutions** - Creating a synergistic web of stable financial institutions which provides minimally supportive environment will spur the growth of the venture capital industry and initiating a co-evolutionary dynamic with other institutions.
- **For Regulators -** Like in USA, Government of India should play a significant role in promoting VC indirectly by following sound monetary and fiscal policies ensuring relatively low inflation which led to stability in the financial environment and currency. Ensuring favorable tax policy and decreases in capital gains taxes may have some positive effect on the availability of venture capital. The stock market, which has been the exit strategy of choice for venture capitalists, should be strictly regulated and characterized by increasing openness. This will create a general macroeconomic environment of financial stability and openness for investors, thereby reducing the external risks of investing in high-risk firms.
- **For Academicians -** Non availability of reliable data on the performance of VC industry in India with respect to deals, fundraising and exit will be a hurdle but primary surveys can be conducted in order to deepen the understanding of VC industry in India and bring more transparency

CHALLENGES

Venture capital is increasingly becoming an important financial intermediary which is able to transform capital into new firms in an apparently highly productive manner. This intermediary is attracting increasing interest by policymakers and investors, but the availability of data as well as the consistency of the academic findings using these data are still lacking. The economic stabilization, strong growth, and favorable business outlook in the countries of the US have provided a strong foundation for an active and developing venture capital industry. Reflecting the relative lack of disclosure and the substantial information asymmetries surrounding venture capital, it is difficult to paint in definitive terms the level of investment activity and fund performance. Existing databases differ in methodologies, and analyses frequently produce discrepancies and varying conclusions. These problems are particularly prevalent when it comes to transaction-level data. That being said, the venture data space has seen substantial entry, particularly in regard to performance measurement. As a result, the quality of information available has increased in recent years and can be expected to continue to do so going forward.

CONCLUSION

In the United States and in India the development of venture capital has been a co-evolutionary process. This is particularly true in India, where it remains a small industry precariously dependent upon other institutions, particularly the government, and external factors such as international lending agencies, overseas investors, and successful Indian entrepreneurs in Silicon Valley. The growth of Indian venture capital must be examined within the context of the larger political and economic system in India. As was true in other countries, the Indian venture capital industry is the result of an iterative learning process, and it is still in its infancy. If it is to be successful it will be necessary not only for it to grow, but also for its institutional context to evolve. The possibility and ease of cross-national transference of institutions has been a subject of debate among scholars, policymakers, and industrialists during the entire twentieth century and there is no denying of the role of VC industry in investing risk capital successfully, there is no reason to believe that the success of a startup solely related to it being backed by a VC and hence, However, venture capital and entrepreneurship are separate phenomena, even among growth companies, and conflating the two, let alone implying that the former causes the latter, is untrue and unhelpful.

SCOPE FOR FURTHER RESEARCH

The VC industry has reached an inflection point wherein the returns have stagnated and declined as compared with the go go years of late 1990's. This points to the new debated regarding right sizing the VC industry, whether it should be big enough in terms of underling financial commitment or more equipped to catalyse the high growth firms? Should it be smaller to take more risks, drive higher returns, and thus keep investors satisfied?

Second, another area for future research is cross-border venture capital investments and local venture capital markets. A relevant question relates to how important cross-border investments are for the development of a local venture capital market. On one hand, foreign venture capital firms could subdue the local venture capital market by "picking the cherries." On the other, they could help in generating a critical mass of venture capital activities.

Third, the major question arises that whether this US model should be replicated to the rest of the worlds as it is or the model has to undergo changes in order to adapt to different financial markets around the world.

Fourth, does reputation follow general partners who start their own fund or must they establish new reputations? In markets without experienced venture capitalists, how can the lack of reputation be overcome? Clearly, more work is necessary.

Thus, an active venture capital market can boost economic growth which is driven by innovation, spearheaded by young entrepreneurial firms by solving the problem of moral hazard and asymmetric information, thereby connecting idea-rich entrepreneurs with cash-rich investors.

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